No. 15434

In the

United States Court of Appeals

For the Ninth Circuit

AH PAH REDWOOD CO., A California Corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPELLANT'S REPLY BRIEF

Petition to Review a Decision of the
Tax Court of the United States

HONORABLE ERNEST H. VAN FOSSAN, *Judge*

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PRELIMINARY STATEMENT

Respondent does not question Appellant's contention that the record does not support a finding that it was engaged in the trade or business of selling timber or that the timber in controversy was held primarily for sale to customers in the ordinary course of business. Furthermore, Respondent has announced that Appellant would be entitled to capital gains treatment of all income received by it from sales of timber cut from the property in question, regardless of whether said

timber was held primarily for sale to customers in the ordinary course of business, provided that the other terms of the statute (1939 IRC § 117 (j) and 1939 IRC § 117 (k) (2), now 26 USCA § 1231 (b) and 26 USCA § 631 (b), respectively) are satisfied (Resp. Br. 9-10).

Because of the importance of the opinion entered by the Tax Court in this case, and its subsequent effect on the entire timber industry[1], Appellant respectfully urges this court to definitely set forth, in its opinion of this case, a statement to the general effect that, notwithstanding a statement of the Tax Court to the contrary, a taxpayer is entitled to capital gains treatment of income derived from the disposal of timber, under the provisions of § 117 (j) and § 117 (k) (2), Internal Revenue Code of 1939, without regard to the nature of the taxpayer's business or the purpose for which the timber is held, provided the taxpayer satisfies the other requirements set forth in the statutes cited.

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1 See 35 Taxes 343 (May, 1957) Confusion under Timber Provisions of Sections 631 and 1231.

REPLY TO POINT I OF RESPONDENT

The oral agreement by the Appellant and Coast Redwood Co. did not constitute a disposal of timber under the then existing laws and regulations.

The Stipulated facts regarding the agreement in question provide the following (R. 18):

> "Shortly after this purchase, taxpayer, in October, 1947, under an oral or implied contract with Coast Redwood, allowed the latter to begin cutting timber from the Sage Tract and pay therefor $5.00 per thousand feet as removed."

The statute in question, 1939 IRC § 117 (k) (2), provides in part:

> "In the case of the disposal of timber (held for more than six months prior to such disposal) by the owner thereof *under any form or type of contract* by virtue of which the owner retains an economic interest in such timber, * * *" (emphasis supplied)

In his Brief, Respondent fails to distinguish an elementary principle of contract law which, upon the facts of record, is determinative of the question before the Court.

Respondent rests his argument upon the basic assumption that the agreement referred to above constituted a "disposal" of the timber upon the date of

said agreement, because it was a form or type of contract referred to in the statute. Yet the very terms of the stipulation refute this contention.

There can be no contract without mutuality of obligation. There can be no contract without consideration. There can be no contract without offer and acceptance.

The facts of record, as agreed upon by Respondent, establish that Coast Redwood Co. was *permitted* to cut timber from the lands in controversy and to pay for such timber *as cut and removed*. Patently, Coast Redwood Co. was not required to remove any timber, and until timber was removed, *there was no obligation owed by Coast Redwood Co. to Appellant.*

In 46 Am Jur 236, Sales § 47, there appears this statement:

> "It is settled law that a mere offer to buy or sell, until accepted by the person to whom such offer is made, imposes no obligation upon either party."

In *Eldorado Ice & Planing Mill Co. v. Kinard* (1910) 96 Ark 184 131 SW 460, it was held that mutuality of contract means that an obligation must rest on each party to do or permit to be done something in consideration of the act or promise of the other and

therefore neither party is bound unless both are bound. *A contract which leaves it entirely optional with one of the parties as to whether or not he will perform his promise is not binding upon the other.* This rule has been generally followed in all courts. See the cases collected in an annotation at 26 ALR 2d 1139.

This general rule has been repeatedly applied by the Federal Courts.

In *Willard, Sutherland & Co. v. U. S.*, 262 U.S. 489, 67 L Ed 1086, 43 S Ct 592 (1923), there was a contract providing that the government, depending upon its own choice, might call for whatever amount of coal the Government decided to buy from the contractor. The contract provided "* * * the contractor will furnish any quantity of the coal specified (i.e., of the kind and quality specified) that may be needed . . . irrespective of the quantities stated, *the government not being obligated to order any specific quantity* . . .;' and that the stated quantities 'are estimated and are not to be considered as having *any bearing* upon the quantity which the government may order under the contract * * *." In holding the contract void for want of mutuality, the Court said:

> "There is nothing in the writing which requires the government to take, or limited its demand to, any ascertainable quantity. It must be held that, for lack of consideration and mutuality, the contract

was not enforceable. *Cold Blast Transp. Co. v. Kansas City Bolt & Nut Co.* 57 L.R.A. 696, 52 C.C.A. 25, 114 Fed. 77, 81; *Fitzgerald v. First Nat. Bank*, 52 C.C.A. 276, 114 Fed. 474, 478; *A. Santaella & Co. v. Otto F. Lange Co.* 84 C.C.A. 145, 155 Fed. 719, 721, et seq.; *Golden Cycle Min. Co. v. Rapson Coal Min. Co.*, 112 C.C.A. 95, 188 Fed. 179, 182, 183."

In *Curtiss Candy Co. v. Silberman*, 45 F2d 451 (1930), Plaintiffs, who were jobbers, agreed with defendant to undertake exclusive distribution of defendant's product in a specified area. In holding the agreement void for want of mutuality, the Court said:

"Standing orders were placed, and from time to time modified, and shipments were periodically made thereunder; but neither orally, nor by the original or standing orders, nor through correspondence, did the parties enter into a definite agreement binding the defendant to furnish in the future, or the plaintiffs to buy, any specific quantity, or to maintain the relationship for any given period of time, or fixing prices, terms, etc. Recovery was based solely upon a breach of the alleged contract for exclusive representation. Considered as one of the covenants in, and as an integral part of, the broader contract for the marketing of defendant's products, the grant of exclusive territory must fail with the unenforceability of such marketing contract. Matters of quantity, type of merchandise, price, and other items being left undetermined, the negotiations of the parties can at best be considered as resulting in a series of separate and independent sales, each complete in itself, and each consisting of its individual order, accepted and the sale completed on the part of defendant by delivery of the merchandise. There was undoubtedly a mutual

expectation of an indefinite continuance of this relationship, but the contract lacked that mutuality necessary to make it enforceable in so far as executory obligation was concerned. *Willard Co. v. U. S.*, 262 U.S. 489, 493, 43 S.Ct. 592, 67 L.Ed. 1086; *Wakem & McLaughlin v. Culver*, 28 F.(2d) 942 (C.C.A. 6); *Am. Merch. Marine Ins. Co. v. Letton*, 9 F.(2d) 799 (C.A.A. 2); *International Shoe Co. v. Herndon*, 135 S.C. 138, 133 S.E. 202, 45 A.L.R. 1192."

See also *Bendix Home Appliances v. Radio Accessories Co.*, 129 F2d 177 (1942), and *Brooks v. Sinclair Refining Co.*, 139 F2d 746 (1944).

Here there is no record whatever of any agreement requiring Coast Redwood Co. to cut or purchase or remove any timber from the lands in question. *The agreement of October, 1947, places no obligation upon Coast Redwood Co.* It is, therefore, an agreement *void* for want of mutuality.

Respondent contends that Appellant must establish that the timber was sold under the provisions of 1939 IRC § 117 (k) (2) (Resp. Br. 10). However, if, as to timber cut and removed by Coast Redwood Co. subsequent to April, 1948, Respondent relies upon an earlier disposal, it is for Respondent to establish that such a disposal was made. This Respondent has not and cannot do, and having failed to establish such contract, his entire argument fails.

The statute does not refer to a written contract. It states "under any form or type of contract." This includes a unilateral contract, which becomes binding upon performance of acts by the offeree. Here the act required was the cutting and removal of the timber. Only at that time did any obligation of Coast Redwood Co. to Appellant arise. Prior to cutting and removal by Coast Redwood Co., Appellant, at its discretion could withdraw permission to cut, alter the price of timber not yet cut, or impose any other condition it might desire.

The case upon which Respondent relies to establish that there has been a disposal within the terms of the statute is *Springfield Plywood Corp. v. Commissioner*, 15 TC 697 (1950) (Resp. Br. 13-15). Without arguing the merits of that decision, Appellant submits that the case is clearly distinguishable upon its facts from the case at bar.

The opinion clearly reflects that in the *Springfield* case there was a valid contract executed by the parties, and by its terms the contract provided for complete disposal of the timber within a fixed period. The Court said (at page 699):

> "* * * that cutting and removal of timber should commence by June 1, 1943, and proceed continuously, except for causes beyond vendees' control, at the rate of 45,000 feet per day, 'the cutting

license hereby granted' to terminate 2 years from the date of contract; * * * 'this agreement shall not become effective until and unless' within 20 days from the date thereof the vendees should execute to the vendor a performance bond or deposit $5,000 or execute to the vendor a chattel mortgage for $5,000 upon property worth $10,000, to insure performance of the agreement; that injury to or destruction of any of the timber, whether cut or uncut, by fire or the elements or otherwise should be at the vendees' risk, they to make full payment for the timber notwithstanding such loss or damage; * * * that 'it is the intent of this contract that the vendee shall purchase and pay for all the standing and down timber on said lands on or before two years hereof' and that if at the expiration of that period 'any timber agreed to be purchased' shall not have been cut, removed and paid for, the amount of such timber shall be determined and the vendees shall pay therefor at the prices specified, but without any right of removal thereof; * * * that the vendees agree that it is a condition of the contract and the cutting license granted that they will pay all taxes upon the real property until they have cut, removed and paid for the timber agreed to be purchased; * * *"

The authorities cited indicate that the agreement in the *Springfield* case constitutes an enforceable contract; *such is not the case in the agreement between Appellant and Coast Redwood Co.*

It is therefore apparent that there being no contract, of any nature or type, there cannot be a disposal of the timber in October, 1947, under the terms of the

statute. There is no form or type of *contract* for disposal of timber, binding in the present and future and not subject to the complete right in the seller to terminate it at any time.

Logic therefore forces the conclusion that separate sales of the timber occurred as the timber was cut and removed by Coast Redwood Co. Since there is no earlier contract of disposal to which the sales can relate, amounts received by Appellant subsequent to April, 1948, were properly reported as long-term capital gains, under contracts completed by the acts of cutting and removal by Coast Redwood Co.

Appellant's returns are correct. The judgment of the Tax Court must be reversed.

II

Appellant is entitled to increased depletion allowances for the years 1948 and 1949.

Respondent's statement (Resp. Br. 17) that no issue exists concerning depletion, if Appellant is entitled to capital gains treatment on the transactions in question, is incorrect. Respondent ignores the difference between ordinary income and capital gains tax rates.

If Appellant is entitled to capital gains treatment, then under its theory, no contract for disposal arises

until the timber is cut and removed by Coast Redwood Co. Until the date of actual disposal Appellant is entitled to increased depletion allowances. Appellant seeks only recovery of its capital investment, and not, as Respondent contends (Resp. Br. 17), a double deduction.

Respondent argues (Resp. Br. 21) that a downward revision of depletion allowance becomes effective on the date when the taxpayer has or should have ascertained that such revision was necessary, but when an upward revision is required, only the Commissioner is to ascertain the date of adjustment. It is obvious that the regulations do not contemplate a double standard for determination of depletion allowances and the date of adjustment thereof.

A distinction must be made between minerals that are below the ground and invisible, and are therefore of uncertain quality and amount, and timber which lies above the ground and is visible and available for determination of quality and amount. Here the years in question are open to adjustment, and under the authority of *Beck v. Commissioner*, 15 TC 642, Aff'd 194 F2d 537 (1952), the adjustment of such allowances is to be made at the time when Appellant first knew or *should have known* of the discrepancy in the amounts of timber available for depletion.

Here the depletion allowance will be increased. However, the facts should have been known to Appellant and Respondent during the years in question, and Respondent cannot now be allowed to complain if the resulting adjustment is upward instead of downward.

Appellant's claim for adjustment of depletion allowance during the years 1948 and 1949 is justified. The adjustment is authorized by law. The decision of the Tax Court must be reversed.

CONCLUSION

The authorities presented by Appellant clearly entitle it to the relief which it seeks. Appellant is entitled to capital gains treatment on amounts received from Coast Redwood Co. for timber sold during 1948 and 1949. It is entitled to adjusted depletion allowances for its timber held until the date of disposal. The judgment of the Tax Court of the United States must be reversed.

Respectfully submitted,

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